A STUDY ON THE IMPEDIMENT OF CAMBODIA'S GARMENT INDUSTRY IN THE POST-QUOTA PERIOD

By
Khlang Sokha

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

MASTER OF PUBLIC POLICY

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Professor Yo, Il-Ho

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ABSTRACT

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The Cambodian garment industry is in a unique position. It has grown very quickly (presently involving around 196 companies with around 230,000 employees of whom 85-90% are women) but has been almost exclusively driven by foreign investment and by comparative advantages resulting primarily from preferential access to the major markets and, to a lesser extent, by cheap labor. In recent years, the industry has been considered one of the most compliant in terms of labor practices and Cambodia has been awarded incremental increases in quota allocations by the US government (an additional 14% in 2004 of a possible increase of 18%). The industry remains virtually 100% foreign owned, with most of the decision takers largely based in East Asia from where production orders are received together with fabric and accessory supplies and delivery instructions. These foreign owners make decisions about operations in Cambodia based on global business developments and most have similar operations in other countries, such as China. The industry is almost 100% dependent on imported yarns, finished woven and circular

knitted fabrics, all accessories, and almost all packaging and presentation materials. The domestic material content is limited to some cardboard cartons and poly bags. The domestic value added content of the Cambodian garment industry amounts to 28.6% of garment exports.

The garment industry worldwide, quota system was finally phased out in 1 January 2005. The ending of this system was likely to intensify the following major industry trends: Cost competitiveness continues to be a key factor as garments prices continue to decrease from time to time. Buyers are requiring faster deliveries to meet up increasing levels of consumer demand. Buyers want business to be as straightforward and uncomplicated as possible. They will have a greater choice after the ending of quotas, and they will buy from preferred suppliers who offer consistent quality, reliable delivery dates, competitive prices and productivity levels at international standards. Foreign investors will have more freedom in where to place offshore investments after the ending of the quota system and will prefer host countries that enable successful operations with the least problems. In general, the global garment market has been demanding higher levels of (a) personal service, (b) quality consistency, (c) delivery lead times, (d) product innovation, (e) price competitiveness, (f) reliability, and (g) country image (including compliance with corporate codes of conduct). The overall impact of the new global market environment on Cambodia's garment exporters, and in particular the increasing competitiveness in the global textile and clothing (T&C) industry, is expected to be a reduction in exports, re-trenched workers without alternative job opportunities, and a downturn in the national economy. Urgent action is needed now to prevent this from happening.

Two major elements of the Cambodian economy and society deserve consideration as the

context within which the garment industry has developed. First, the important role of the garment industry in addressing issues relating to poverty and female worker empowerment in Cambodia. While Cambodia still reports the lowest Gender Development Index in Asia, there is no doubt that employment opportunities in the garment industry have played a significant role in alleviating poverty and in raising the profile of women workers. Any changes in the industry – either positive or negative – will have strong effects on the progress made so far. Second, the overall investment climate in which the garment industry is operating. The top priorities of the business community in Cambodia are governance, the rule of law, and corruption. The serious constraints posed by these factors in Cambodia, as well as the dilapidated infrastructure, are likely becoming even more acute as Cambodian-based garment businesses face an increasingly competitive global marketplace in the post-quota period.

Approximately one-quarter million Cambodians are employed in the garment industry. Labor is supplied mostly by young women from rural villages whose remittances back home sustain an estimated 20 percent of the country's 13 million people. These workers' incomes are critical to their families, the country, and even the region. The social, economic, and political ramifications of potential widespread factory closings in response to global garment market shifts are the great concern to industry players and policy analysts alike.

ACKNOWLEDGEMENTS

I am particularly grateful for the most generous financial support provided throughout one year scholarship master program by Korea International Cooperation Agency (KOICA) in partnership with Korea Development Institute and Management (KDI School), its staff and professors gave generously of their valuable time and insights. I would also like to thank many members of the garment industry as well as the major non-government organizations (NGOs) and business associations for their contribution of data and inputs. Without the benefit of their information, experience and opinions, this study would not have been possible. I greatly appreciate the contribution of the legal professionals and consultants of Cambodian executing agencies that provided time, information and recommendations to this study. Since the garment sector involves such a wide range of topics and issues, it has been vital to have the support of these organizations and individuals.

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PART 1: INTRODUCTION

Elimination of global textile and apparel trade quotas on January 1, 2005, has brought about a dramatic shift in the world market for textiles and apparel products. Cambodia, with its poor skills of labor workers, insignificant upstream capacity in textiles manufacturing, inefficient garment factories, and worse logistics infrastructure, has failed to achieve breathtaking gains in exports in just the first few months of quota-free trade, and has clearly suffered in comparison. Downward pressure on world prices has been strong of uncontrolled competition. Cambodian producers have been benefiting from uncertainty among U.S. and EU buyers, many of which are retaining multiple sources of supply.

The purpose of this study is to identify strategies for improving the competitiveness of Cambodia's garment industry while maintaining Cambodia's strong record on labor standards. We emphasize, in particular, the substantial scope for increasing labor productivity through improved management systems and training. We study the competitive strengths and weaknesses of Cambodia's garment manufacturers, benchmarking productivity in Cambodia against that of garment industries elsewhere.

1. Setting the Scene

This part presents the current situation of the Cambodian garment industry – moving from sections on the status of women and investment climate in Cambodia to sections highlighting key trends and developments in the global garment industry.

1.1 Status of Women in Cambodia

Cambodia has the lowest Gender Development Index 0.427 in Asia. The Gender Empowerment Measure (GEM) of 0.283 is also among the lowest in Asia due to the low

representation of women in national decision-making institutions and professional spheres. Further, Cambodian society is said to be characterized by entrenched inequality, in many essential dimensions such as income poverty (the consumption share of the poorest 10% of the population being as low as 4%, while the richest 10% have a consumption share of 20%), gender status and access to education and health. Marked regional differences within the country heighten these inequalities. An estimated 36% of the population lives below the basic needs poverty line, with rural households accounting for almost 90% of the poor. The high prevalence of HIV/AIDS, drug abuse, and the trafficking of female children, poses major threats to economic and social development. As a result of decades of civil war, isolation and low public expenditure on education (2% of GDP), health and other social sectors, quality of life in Cambodia has been negatively affected. Female literacy rate is at best only 41%. It is therefore not surprising that a majority of the young women who migrate for employment in the garment sector are illiterate. Overall the legacy of human suffering and mass destruction of the physical and social infrastructure has had a profound impact on poverty, and places a huge burden on women in particular. The social and institutional dimension of gender-based constraints, although documented globally, is often not given adequate attention in poverty analysis and the formulation of macro economic and trade policies. The issues to be examined revolve around social norms (women viewed with reservations after working in the garment industry), as well as social and physical infrastructure available to women to allow them to meet their work commitments and demands. Their presence, role and participation in organizations such as trade unions, chambers of commerce and in markets for labor, goods and credit are determined by their social status. It is recognized

that at the operational level, these gender inequalities and gender biases can have serious costs for the economy as a whole. A recent publication (April 2004) of Ministry Of Women's And Veteran's Affairs, A Fair Share for Women, presents a comprehensive assessment of the status of women in Cambodia based on secondary data. The overall conclusion of the assessment is that "Gender relations in Cambodia continue to undergo uneven change: The cultural norms still firmly place women at a lower status than men. This continues despite the fact that women play an equally important and increasingly visible role as income providers for families and are a driving force for economic development". Following are some of the findings of the Assessment of the Status of Women in Cambodia: Families often fear that girls who move to urban areas will be corrupted and not be "good" for marriage (ADB 2001). Women and girls still work longer hours and have less leisure time than men. According to the Cambodia Demographic and Health Survey, during the rainy season women work almost 18 hours a day while men work for about 14 hours; during the dry season women and girls work about 15 hours while men and boys work 10-12 hours. The same survey found that many women believed that important decisions should be made by men (52%), that it is better to educate a son than a daughter (59%), and that married women should not be allowed to work outside the home (33%). The Human Poverty Index (HPI) is a composite measure of the percentages of people who are not expected to survive to age 40, who are illiterate, and who have no access to safe water and health services, as well as the percentage of moderately and severely underweight children under 5 years of age. As would be expected, given the high levels of mortality and child malnutrition and the poor availability of public services indicators used in the construction of the HPI, Cambodia

has a high HPI in relation to other Asian countries. Only Bangladesh and Pakistan score a higher HPI than Cambodia. Analysis of the HPI also reveals that poverty is greater among Cambodian women than among men across all economic groups. Female-headed households (34%) are among the poorest in any community. A large number of "gender studies" use women–headed households as the unit of analysis. As the level of poverty has been calculated at the household level, assessment of gender differences focused on separating data based on the sex of the household head. The 1999 Poverty Profile of Cambodia (Ministry of Planning, 1999) found that although the poverty headcount index for women-headed households (34%) was slightly lower than that of male-headed households (36%), the difference was not statistically significant. The poverty profile concluded "there is no difference in poverty rates between male and women-headed households". Women are under–represented in professions and decision-making. Approximately one third of professionals are women and only 14% of legislators, senior officials and managers are women. Less than 2% of all economically active women are employed in the predominantly public sector industry groups of public administration/defense, education, and health/social work, compared to 8% men. Gender disparities in education are greatest in rural areas and among the poor. The gender gap increases with level of education. Notably, the fastest increase in school enrollment is for girls from the poorest communes. However, survival and education completion rates remain lower for girls. Women in Cambodia have poor nutritional status and maternal mortality in Cambodia is among the highest in the region. Approximately 2,000 Cambodian women die each year of pregnancy and childbirth-related causes (calculated as an approximation based on maternal mortality and crude birth rates), including deaths

due to abortion, hemorrhage and eclampsia. Similarly, infant mortality rates are also much higher than, for example, in Viet Nam, China or Thailand.

1.2 The Business Climate in Cambodia

Both the public and private sectors have long recognized the significant challenges faced by the business sector in Cambodia. In late 2002, a representative from the Cambodian Investment Board (Hing Thoraxy, 2002) identified the following key issues facing the business community:

- Weaknesses in the legal system;
- Costs of and access to finance;
- Inadequate market information on consumer trends;
- Shortages of skilled labor;
- Inadequate infrastructure that restricts access to markets and raw materials;
- The quality of the port facilities;
- The high cost of essential utilities and services, i.e. electricity, water supply, and telecommunication services; and
- Land issues for agriculture investment projects.

In order to provide a more systematic evaluation of the Cambodian investment climate and to provide policy advice based on both an assessment of the business climate in Cambodia and that of major competitors, the World Bank carried out a Cambodia Productivity and Investment Climate Survey (PICS) in 2003. The PICS is analyzed in World Bank, 2004, and represents by far the most comprehensive evaluation of the investment climate in Cambodia to date.

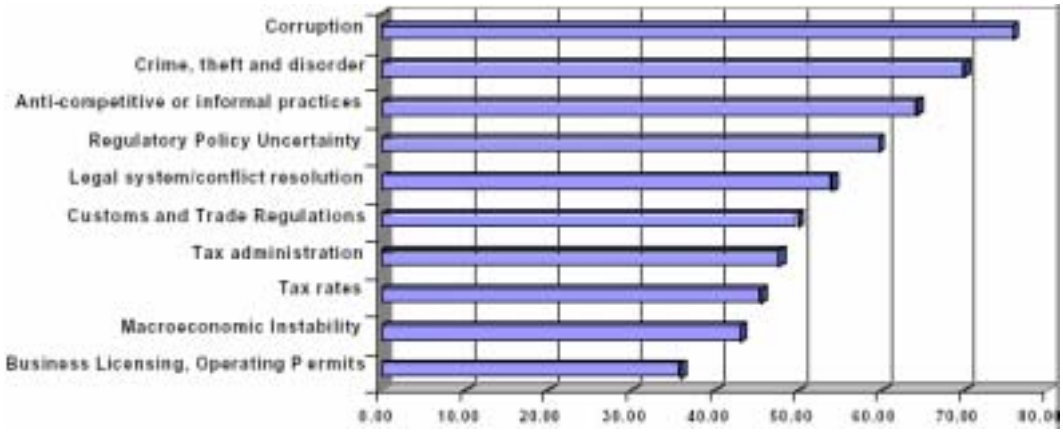
Overall Evaluation of Constraints: Overall, the survey found that the top priorities of

private companies in Cambodia involved governance, the rule of law, and corruption. Figure 1 shows that corruption was ranked as the number one constraint for business, with security as number two, and anti-competitive or informal practices as number three.

Figure 1

Cambodia: Top General Constraints to Private

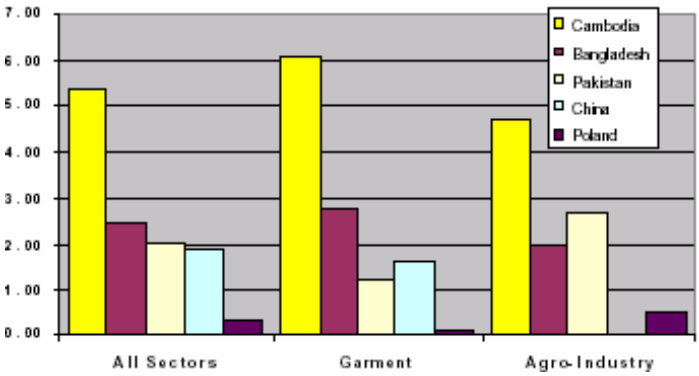
Enterprise Operation and Growth



Source: World Bank, 2004; Data for the year 2003

Governance and Corruption: 82% of companies reported that they needed to pay bribes in order to conduct business, and the average level of such payments amounted to between 5% and 6% of total sales. This places Cambodia significantly higher than Bangladesh – at around 50% of Cambodia levels – one of the country's main competitors in the garment industry. In addition, companies operating in Cambodia viewed the integrity of the bureaucracy as very weak, reinforcing the widely held view that dramatic reforms in all areas of public sector governance are required to improve the business environment.

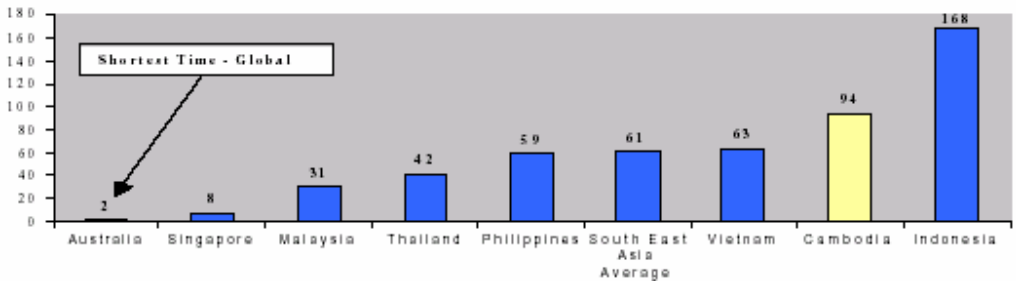
Figure 2: Percent of Sales Value Paid Informally to Public Officials



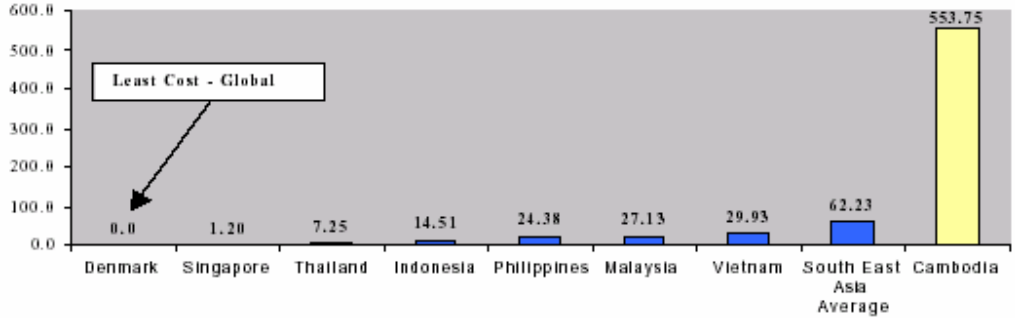
Source: The World Bank, PICS for each respective country.

Business Operations: Two key measures of the ease of doing business concern the time taken to start up a business and the cost of starting up a business. Cambodia scores considerably higher (in terms of time and money) than major competitors in South East Asia, especially in terms of costs

Figure 3: Time and Cost to Start a Business



Cost to Start a Business (% of income per capita)



Source: The World Bank

Trade Facilitation: The World Bank clearly identifies the negative aspects of trade facilitation – high costs of corruption and long delays for clearance procedures – as a critical issue affecting productivity and competitiveness in Cambodia, with each step in the exporting process characterized by delays, formal costs and informal payments. In addition to the time taken, companies particularly object to the arbitrary nature of the procedures that are seen as unclear and often superfluous. Again, it is found that Cambodia scores lower even than Bangladesh in terms of the longest time taken to clear customs. In the garment industry, for example, it takes up to 19 days in Cambodia to clear customs, while in Bangladesh it takes only 14 days.

Regulatory Environment: Factory inspections, especially related to tax matters, and arbitrary interpretation of policies and regulations create serious burdens on companies operating in Cambodia. In particular, Cambodian companies face an average of 16 government inspections per year, compared to 14 in China and only 8 in Bangladesh. In terms of management time spent in dealing with regulations, Cambodia overall fares slightly better than China, but much worse than Bangladesh. However, if the garment industry is singled out, then Cambodia is worst, with managers spending over 16% of their time dealing with regulatory matters.

Other Constraints: Although not mentioned by companies as among the top constraints, other factors affecting business include a range of issues relating to: access to capital and finance; availability of skilled and managerial workers; availability and quality of infrastructure – power, telecommunications, water and sanitation, transport; and logistics services.

1.3 A Snapshot of the Cambodian Economy

Cambodia's most pressing social and economic challenge is poverty-reduction. Annual GDP per capita at current prices has changed hardly since the mid-1990s – from approximately US$284 in 1995 to $266 in 2000. Rapid population growth (3 percent annual), rapid labor force growth (3.4 percent annual), insufficient employment creation, and low productivity growth are part of the poverty equation in Cambodia. Initial evidence suggests that trade can play a significant role in helping break through this vicious circle.

A root-cause of poverty in Cambodia, today, can be found in the current structure of the country's economy. Annual GDP growth (in constant prices) in the agricultural sector was a low 2.75 percent during the second half of the 1990s (1994-1998.) In contrast, GDP grew at an annual rate of 4.5 percent in the service sector and 9.50 percent in the manufacturing sector during the same period. Most striking was growth in the export sector (goods and services) with an annual rate possibly as high as 20-25 percent. From 1994 to 1999, all exports (goods and services) grew from approximately 15 percent to nearly 30 percent of GDP.

However, agriculture still represents 43 percent of GDP and, more importantly, continues to employ over three–fourth of the labor force (77.5 percent.) In contrast, manufacturing and services contribute 57 percent of GDP, while employing only 22.5 percent of the labor force. The export sector, which may now contribute close to 25 percent of GNP, employs no more than 6 to 7 percent of the labor force. In sum, an overwhelming share of Cambodia's labor force remains employed in the slowest growing sector of the economy and that sector is primarily the rural, agricultural sector.

The Second Social-Economic and Development Plan (SEDP-II) estimates that Cambodia needs to create 150,000 or more new jobs each year over the next five years in order to absorb young people entering the labor market and re-deploy demobilized soldiers. The economy, in recent years, has not been able to produce jobs at such a high rate and the results have been a tripling of official unemployment rates (1.9 percent in 1994 to 7.1, percent in 2000) and, more significantly, a considerable increase in rural underemployment. Simply put, more and more rural workers are working to produce an almost unchanged agricultural output. The overall result is the stagnation in national output per capita noted earlier.

Part of the solution to this problem clearly lies in a combination of two developments: first, more rapid growth in agriculture through increases in productivity and the development of new markets; and, second, more rapid growth in the manufacturing, service, and export sectors.

1.4 Garment Industry Trends and Projections

The global textiles and clothing industry has developed into a major activity in many countries that previously had little or no manufacturing sector, and this is the case in Cambodia. In order to understand the background and possible future of the garment industry this section of the study examines the general implications of the ending of the quota system, looks at future market trends, and considers changing agendas in market access, especially in view of China's accession to the WTO and more complete entry into the global garment market.

1.5 The Quota System and Implications of its Ending

The global textile and garment industry has expanded continuously to meet the demands of a growing world population with increases in standards of living worldwide and diversification of end-use applications. In 1950, for example, the consumption of fiber by the world's textile mills was 7 million tons – and that increased to almost 55 million tons in 2003. It is interesting to note that polyester, first discovered by The Calico Printers' Association in Manchester, UK in the early 1950s, now represents about 65% of total fiber consumption, i.e. about 36 million tons. The principle end-use applications for textiles fifty years ago were in the manufacture of garments (about 84%) and home textiles, e.g. bed linen, furnishings, towels, etc., (about 12%) whilst other end uses represented some 4%. Today, one of the key growth areas for textiles is in industrial textiles, e.g. fabric substrates for the production of shoes, airbags for cars, buses, etc., and in technical textiles, e.g. geo-textiles, agro-textiles, and construction textiles. The Multi-Fiber Arrangement (MFA) was introduced by the major, high cost textile and garment industries in the late 1960s–early 1970s as a means of protecting their declining textile industries by restricting imports from the then established textile and garment exporting countries, e.g. China, Egypt, Hong Kong, India, Republic of Korea, Pakistan, Taiwan, Thailand, Turkey, etc. The quantitative restrictions, known as quotas, were introduced through bilateral negotiations or, if discussions failed to reach agreement, restrictions were imposed unilaterally. The objective of the quotas was to enable the textile and garment industry capacities in the higher cost countries to be reduced at a controlled rate. This reduction has taken place over the last 30 years. One of the apparently incidental results of the MFA has been the transfer to, and growth of textile and garment industries

in, many countries that previously had no significant textile or garment manufacturing traditions and, therefore, also had no restrictions on their exports. These countries include Bangladesh, Indonesia, Malaysia and Sri Lanka. Cambodia is one of the later entrants to the global export market with garment export sales first recorded in the middle 1990s. Cambodian garment production, while critical to the economy of Cambodia, remains relatively small in global terms with about 0.3% of garment production worldwide and 0.7% of global foreign trade, by value, based on WTO data. In 1995, the Uruguay Round of negotiations was concluded and the stage set to enable all world trade to return to the General Agreement on Tariffs and Trade (GATT). This involved replacing the Multi-Fiber Agreement (MFA) with the WTO Agreement on Textiles and Clothing (ATC). The ATC is based on a non-extendable 10-year transitional program for the removal of all quotas by 1 January 2005. The critical aspects of the ATC were that the higher cost countries' importers had a further 10 years in which to make the needed commercial, industrial and social adjustments in reducing their production capacities and that the exporting countries had the same 10 years in which to prepare their business strategies to be competitive in the new market situation.

The WTO Agreement on Textiles and Clothing
The completion of the Uruguay Round of negotiations resulted in an agreement to integrate trade in textiles and clothing into the GATT/WTO. In 1995, the Multi-Fiber Agreement (MFA) was replaced by the WTO Agreement on Textiles and Clothing (ATC). The ATC is based on a non-extendable 10- year transitional program for the removal of all quotas by 1 January 2005. Liberalization has proceeded along two paths. One concerns integrating textile and clothing trade into the WTO framework

and the other is related to the application of accelerating growth factors for MFA quotas. The ATC is binding only for WTO Members and is subject to the same set of rules and a single system of resolving disputes, which is applicable to all WTO Agreements. The ATC calls for a gradual phase out of the quota restrictions carried over from the MFA regime. Products covered by the ATC have been integrated in three stages and the percentage of products that must be brought under GATT rules are specified for each step. If any of these products come under quotas, then the quotas must be removed at the same time. In these three stages, the quota growth rates increase progressively from their base levels by increasing annual growth rates at each stage. Products brought under GATT rules at each stage were required to cover the four main types of textiles and clothing: tops and yarns; fabrics; made-up textile products; and clothing.

Source: Adapted from UNIDO 2003

1.6 Issues of Market Access and the Role of China

As quotas in the garment industry were removed completely by 1 January 2005, the issues facing countries in the garment industry with regard to market access shift to a certain extent. This study considers two of the critical issues, namely (a) the role of trade preferences and (b) the role of China. This does not imply that other countries are not a threat; indeed many countries in Asia such as India, Bangladesh, Viet Nam, and others, will compete with Cambodia in export markets. It is simply that China is the largest threat by far.

The role of trade preferences: Since the 1996 Singapore Ministerial Declaration refocused attention on special trade preferences for least developed countries (LDCs), the

early 21st century saw a proliferation of special unilateral programs to grant preferential access to textile and garment products by all members of the Quad countries (US, EU, Japan, and Canada). These included (a) introduction of the US African Growth and Opportunity Act (AGOA) in May 2000 to amend the US GSP scheme in favor of certain Sub-Saharan African countries, (b) introduction of the Everything But Arms (EBA) amendment to the EU GSP scheme in March 2001, (c) expansion of the Canadian GSP scheme to cover textiles and clothing in January 2003, and (d) revision of the Japanese GSP scheme in December 2000 to cover a wider range of industrial products from LDCs. All of these schemes include some form of rules of origin that producers must meet in order to qualify for preferential treatment. In an extensive review of all the major preferential schemes, a recent report by UNCTAD, 2003, highlights a number of key features of these schemes. Overall, in 2001, only 66% of exports from LDCs to the Quad countries were covered by preferential schemes and only 42% of these exports received trade preference at the time of customs clearance.

The role of China: This issue has already been mentioned earlier. In a world with no more quotas in Textile & Clothing and a China that is a member of the WTO, there is little doubt that China will become the world's leading exporter of Textile & Clothing products in the near future. Given that this expansion of activities will probably compete heavily with all existing suppliers, traditional market access will be clearly threatened. In a recent study on the impact of China's accession to the WTO and the ending of the quota system, Spinager and Verma, 2003 (the Consumer Unity and Trust Society [CUTS] report) consider in detail which countries will benefit and which will be badly affected. While Cambodia is not covered in their research, they clearly indicate that those badly

affected will be countries that have relied extensively on quota access for their Textile & Clothing exports. In this regard, Mexico is found to be the worst affected, largely because of heavy reliance on quota free access to the US and Canadian markets. South Asian economies, such as India and Bangladesh, also suffer large declines in exports, in effect wiping out the gains that they were projected to experience following quota liberalization. In order to provide an idea of the extent and speed with which companies based in China will break into previously inaccessible Textile & Clothing markets once the quota system was lifted, a number of examples are cited. These are: (a) when Canada lifted quotas on woven shirts, sourcing immediately shifted to China from countries like Bangladesh, South Korea, Thailand, and Indonesia; (b) the concentration of the toy industry, which does not face quotas, in Greater China; (c) the rapid increase in the Chinese share of the US market for brassieres after China joined the WTO; and (d) the increase to 60% of the market in suitcases and luggage of textile fabrics by the end of 2002, driving Thailand out of the market. The CUTS research team interviewed 14 chief executives of major textile/clothing companies and trading houses in Hong Kong in 2000 and followed up in 2003. These executives reported that (a) the competitive position in China will in fact be greater than would be expected from the actual changes in relative prices due to WTO accession, and (b) particularly of concern to countries like Cambodia, they would be transferring most or all operations into China following its membership of the WTO and lifting of Textile & Clothing quotas. Spinager and Verma, 2003, highlight the issue that, once the quotas were lifted, it was highly likely that the US and EU would feel it necessary to utilize more traditional safeguard measures or impose dumping and countervailing duties. These measures are quite likely to be taken in response to the

expected increase in the inflow of Chinese Textile & Clothing products into their markets. There is no doubt that such measures provide a cushion, albeit a temporary one, for Textile & Clothing exporters that find it hard to compete with China.

1.7 The Impact of the Ending of Quotas on the Cambodian Garment Industry

Prior to the detailed analysis of the garment sector, it is useful at this stage to sum up the main challenges that the Cambodian garment industry is likely to face in the changing market environment.

- Cost: Cambodian exporters have nothing to gain from the ending of quotas, since they presently do not pay quota premiums. Effectively, those competitors where quota premiums are now paid are enjoying cost reductions
- Import prices: Until Cambodian companies take responsibility for their own future development, realize the necessity of understanding the global market and of offering more specific products/service to the markets with precise strategies, it is difficult to see how Cambodia's garment industry performance in terms of realized prices in the major markets can be improved
- Competing countries with integrated textile operations are better positioned in global markets in terms of lower costs (no transport costs for imported materials); reduced lead times (better shipping schedules) and greater manufacturing flexibility (domestic supplies).
- Lower labor productivity levels in Cambodia increase manufacturing costs through lower production, lower quality, and higher material consumption.
- Shipment delays and additional costs caused by bureaucracy, including corruption, contribute to reducing competitiveness of the garment industry in an increasingly

competitive market.

- The presumed strengths of Cambodian garment exporters e.g. lower costs, market access, quality producers, and high levels of labor compliance, still exist but are of reducing interest in the new global market as other countries develop these same strengths and also have other advantages.
- The overall impact of the new global market environment on Cambodia's garment exporters is reducing in exports, re-trenched workers with no alternative job opportunities, and a downturn in the national economy. Urgent action is needed now to prevent this from happening.

PART 2: THE CAMBODIAN GARMENT INDUSTRY

The Contributions of the Garment Industry in Cambodia

2. Key Characteristics of the Industry

This part profiles the Cambodian garment industry with sections on: overall contributions of the industry; structure of the Cambodian garment industry and operational constraints experienced by garment companies, a wide ranging benchmarking of the industry against major competitors; and specific challenges and issues faced by the Cambodian garment industry. It concludes with an examination of market access and regional dimensions of the garment sector.

2.1 Companies, Employment, and Activities

The Cambodian garment industry has developed extremely rapidly within the last 10 years, from a very minor presence in 1995, to become the major manufacturing activity in the country by the late 1990s and early 21st century. In 2003, the garment industry's estimated value added of almost US$500 million accounted for around 12% of national GDP. The garment industry has an estimated 230,000 employees of which 85-90% is female and in the age group 18-25 years. This accounts for around 65% of total manufacturing sector employment. The estimate of 230,000 persons employed directly in the industry can only be an approximate figure since numbers vary considerably during the course of each year as much trade is seasonal. For a number of companies, for example, if the high season requirement were for a 100% workforce, then the low season requirement is only 60% of that number. The work patterns during the low season are met by arranging for some workers to return to their villages for an extended stay, at retainer wages, by releasing contracted workers at the end of their contracted periods, or by

letting permanent employees leave the companies. In addition, there are many indirect jobs associated with the garment industry – perhaps as many as 150,000 related jobs. The garment industry is estimated to have 196 companies in early 2004, located mostly in Phnom Penh and its suburbs with a few in Sihanoukville, near to the main port, and in Kompong Cham province. Fifty-six companies are reported to have closed down since the mid- 1990s, so the total number of companies entering the garment industry has been 242. In addition, there are estimated to be a large number of small cottage industry sub-contracting companies that provide extra sewing capacities during peak demand periods. The industry is virtually 100% foreign owned, with most of the decision takers based in East Asia from where production orders are received, together with the fabric, accessory supplies, and delivery instructions. The foreign owners usually have similar stitching units in other Asian countries and decide in which of their units to have garment orders made-up according to quota availability, product quality, manufacturing costs, and delivery lead time. The attractiveness of Cambodia for foreign direct investment in the mid-1990s was due to the competitive wage cost, no restrictive quotas into major global markets and GSP access to the EU market, with the added advantage that quota premiums that had to be paid in most competing countries were not paid in Cambodia. Consequently, Cambodia had cost competitive advantages over many other countries. As a result, the EU was the main market in the early years. Subsequently, even when some quotas were applied, preferential access to the US market was offered and exports to the US increased significantly. The garment industry is dependent almost completely on imported yarns (for knitwear); finished woven and circular knitted fabrics (for woven and knitted cut and sew garments); all accessories and almost all packing and presentation

materials. The domestic material content is limited to some cardboard cartons and poly bags. As a result, the total average domestic added value content in 2003 was about US$ 442 million, i.e. the difference between the value of exports and imports. Expressed as a percentage of exports, this domestic value added content amounted to 28.6%. The garment industry is considered one of the most compliant in terms of labor practices and Cambodia has been awarded incremental increases in quota allocations by the US government (an additional 14% in 2004 of a possible increase of 18%).

2.2 Exports and Markets

Cambodia's export performance is shown in Table 1. Garment exports rose from about US$26 million in 1995 to over US$1,600 million in 2003. This amounted to almost 80% of total Cambodian exports, and Cambodia's garment exports represented 0.74% of the world total by value. In 2003, exports to the US broke through the billion-dollar barrier for the first time at US$1.1 billion, of which 63% were items under quota. However, the US market share of total garment exports from Cambodia has fallen steadily from a peak of 81% in 1998 to below 70% in 2003. This was due largely to the provision of preferential access to the EU in the late 1990s and early 2000s and is reflected in the increasing share of exports to the EU qualifying for GSP privileges in the last three years. Exports to the EU topped US$407 million in 2003, and following the extension of Canada's GSP scheme to cover textiles and apparel in January 2003, exports to other markets jumped in 2003 to over US$75 million.

Table 1: Cambodia's Garment Exports - 1995-2003, Values and Quantities

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Values (US$ mn)									
US									
Quota					433.3	524.5	501.4	626.5	710.7
Non-Quota					82.8	226.8	327.2	327.1	410.4
Total	0.5	1.6	109.9	291.8	516.1	751.3	828.6	953.5	1121.1
Share of Quota (%)					83.9%	69.8%	60.5%	65.7%	63.4%
US Share of Total (%)	1.8%	2.0%	48.4%	81.2%	78.2%	76.2%	71.7%	71.3%	69.8%
EU									
GSP							143.0	186.4	239.0
MFN							166.1	169.2	168.4
Total	25.7	74.8	112.4	63.1	136.7	220.8	309.1	355.7	407.4
Share of Quota (%)							46.3%	52.4%	58.7%
US Share of Total (%)	96.0%	93.2%	49.5%	17.6%	20.7%	22.4%	26.8%	26.6%	25.3%
Other Markets	0.6	3.9	4.8	4.5	7.3	14.3	17.9	28.1	78.7
Total Garment Exports	**26.7**	**80.3**	**227.1**	**359.4**	**660.1**	**986.4**	**1155.6**	**1337.2**	**1607.1**
Total Merchandise Exports	865.0	717.0	839.0	795.0	1124.0	1394.0	1564.0	1742.0	2056.0
Garment Share of Exports (%)	**3.1%**	**11.2%**	**27.1%**	**45.2%**	**58.7%**	**70.8%**	**73.9%**	**76.8%**	**78.2%**
Quantities (pcs mn)									
US									
Quota					118.0	115.2	156.7	136.9	138.9
None-Quota					30.0	91.3	110.2	172.3	201.6
Total	1.3	8.8	62.2	124.7	148.1	206.5	266.9	309.2	340.5
EU									
GSP							38.5	49.3	67.2
MFN							42.8	41.0	40.4
Total	9.0	2.0	34.3	20.7	34.7	58.3	81.3	90.2	107.6
Other Markets	0.7	2.0	15.2	1.1	3.2	4.4	4.5	7.4	18.2
Total Exports	**10.9**	**12.8**	**111.7**	**146.5**	**186.0**	**269.2**	**352.7**	**406.8**	**466.3**

Source: Ministry of Commerce

2.3 The Contribution of Exports to Poverty-Reduction in Cambodia

Cambodia's current export base remains narrow. Exports of garments dominate the sector (nearly $600 million in 1999) followed by three or four products and services – logs and sawn timber ($180 million,) tourism ($150 million,) remittances of expatriate Cambodian workers ($100 million,) and rubber ($50 million.) Other exports are small; though a number show strong promises (e.g. shoe manufacturing, rice, fish, specialty agriculture and agro processing, handicraft.) Destination markets of current exports are

also limited: the United States, the European Union, Thailand, Malaysia are the dominant destinations.

There is nothing unusual about any of this. These developments reflect the relative newness of the export base that Cambodia has successfully rebuilt over the past five years or so. What is more significant, at this stage, is the contribution of trade to value-added. The average Cambodian worker in 1999 created approximately $570 worth of GNP per annum. For agricultural workers, the average was even lower: probably no more than $300 worth of GNP per annum. In contrast, workers employed in the export sector created anywhere between 70 percent and 250 percent more value-added than the average worker: $1000 per annum for expatriate workers, $1,333 for garment workers and $2,000 or more for tourism sector workers. Clearly, in national income terms alone, exports make a major, positive contribution to the economy.

That being said, a closer look at some characteristics of current exports suggests there is plenty of room for improvement and for Cambodia to capture more benefits from its exports.

A first observation is that, despite the success of recent years, Cambodian exporters often must struggle to remain competitive. The costs of doing export business in Cambodia are often high. This may be so because some of the pieces of our macro and legal framework are still missing, because the incentives for investment are not always the right ones, because of weaknesses in our physical infrastructure, because of the inordinately high costs of trade facilitation (customs and tax administration reforms are yet fully put in place), or for some other reasons.

A second observation is that the multiplier effect of current exports on Cambodia's

economy remains low. Most of the garment sector operates on a CMT basis. Fabric and accessories (e.g. zippers, buttons, thread) are imported and financed overseas and the purchase of local inputs is limited to transportation and freight clearing services, utility-type services to run factories, and construction to build factories. There is very little processing of exported wood or rubber and very little processing of agricultural exports (for example, most rice is exported un-milled.)

Of all current exports, tourism is likely to be the one with the greatest multiplier impact. Typically, hotels and restaurants must purchase local food, sundries, and other inputs including electricity and telecommunication. In addition, tourism generates demand for construction services. The educated guess is that current demand for domestic goods and services by the tourism sector in Cambodia remains on the low-end of the scale. For example, large foreign tourist hotels in Phnom Penh and Siem Reap are said to be importing nearly half of the food they serve their customers. Also, recent large hotel projects (e.g. the construction of the new Sofitel and the renovation of the Grand Hotel in Siem Reap) have had to rely on extensive (and expensive) imports of construction materials from Thailand and elsewhere. Nevertheless this is common to an emerging tourism sector and the experience of other countries shows that, overtime, the domestic multiplier effect increases as domestic suppliers emerge to meet the demand from the sector.

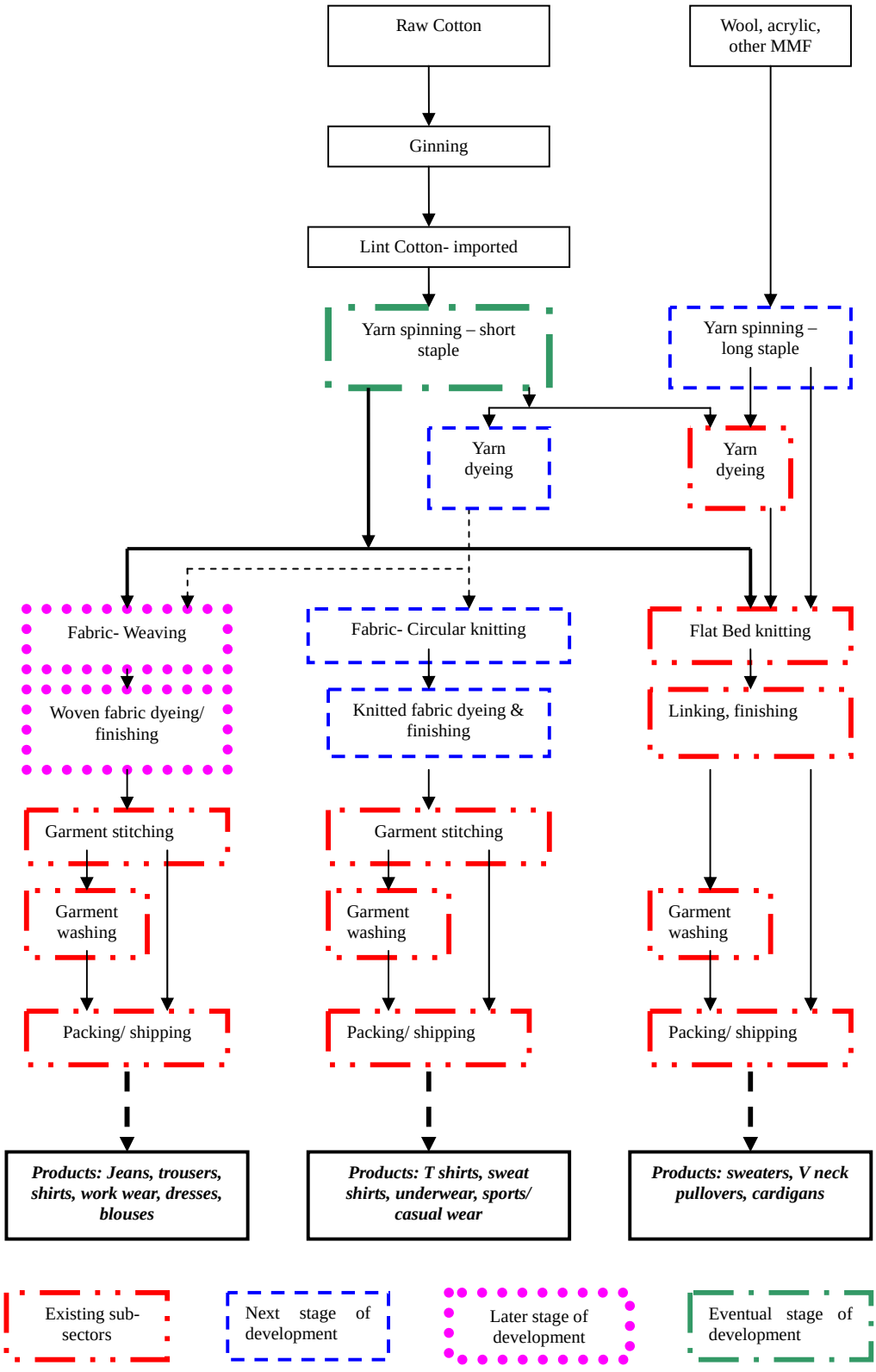
A third observation is that Cambodia needs both to boost the productivity of its current exports and to move up the value-chain. For example, improvements in rice seeds, irrigation, and farming methods would go a long way in increasing both labor and land productivity and strengthening Cambodia’s export capacity in this product. Likewise, a

shift to higher value agricultural production (spices, nuts and seeds, fruits, etc.) and more processing (e.g. milling of exported rice, extraction of essential oils, processing of wood, etc.) would also bring more value from exports to Cambodia. The text box on tobacco for export shows how the combination of a shift from traditional to specialty crop, improved production methods, and better processing can yield significant gains.

3. The Basic Structure of the Garment Industry

The following section outlines the structure and activities of the Cambodian garment industry within the textile and garment value chain for the three major garment types: (1) woven cut and sew garments; (2) circular knit and sew garments; and (3) knitwear garments. First, however, Figure 4 presents a summary of the various positions that the Cambodian garment industry takes in the overall textile and garment value chain. Figure 4 identifies the existing sub-sectors, as well as those sectors expected to be developed in the next stage, in later stages, and at the final stage of industry development.

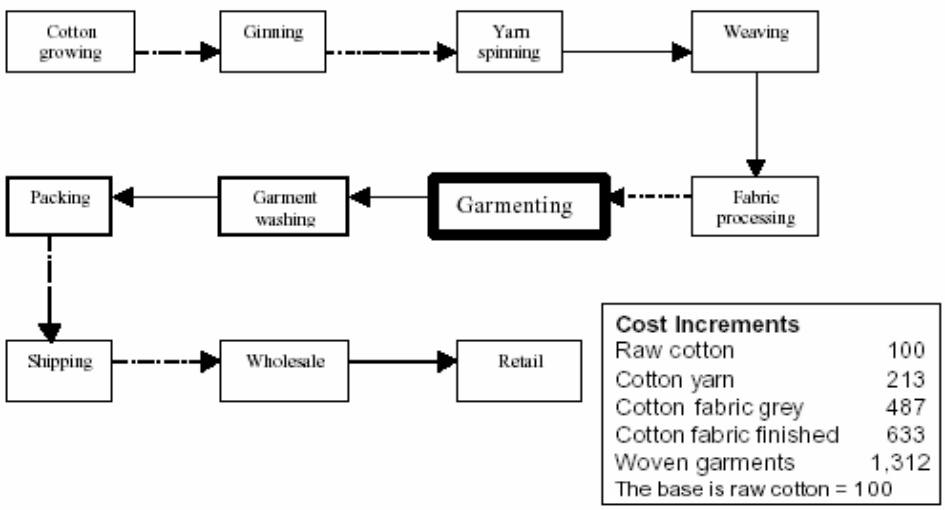
Figure 4: Cambodia's Positions in the Textile and Garment Value Chain



3.1 Woven Cut and Sew Garments

The most common woven garments traded internationally are men's and boys' shirts and trousers made from either 100% cotton or polyester/cotton blends. Typically, shirts may be either classical in a limited range of self-colors that changes little from season to season, or fashion shirts made from dyed yarns or prints. Trousers can similarly be divided into classical and fashion garments. The woven cut and sew garment value chain is illustrated in Figure 5. Cambodia's position in the industry is shown in the boxes shown in bold, i.e. garment manufacture, garment washing and packing. Production orders are generated in the head offices of the offshore owners, who determine in which of their manufacturing locations the garments will be made, e.g. in Cambodia, China, Indonesia, Viet Nam, etc, according to availability of quotas, cost, quality and time. The production orders and all garment components are then sent to the selected manufacturing unit for making up and then exported. The disadvantages of making garments in Cambodia lies in the time and cost of shipping materials to Sihanoukville (via a deep sea port in a third country) and then on to the garment unit; the time and costs of clearing customs (import and export); and the time and cost of exporting the finished garments via Sihanoukville (and on to a deep seaport in a third country).

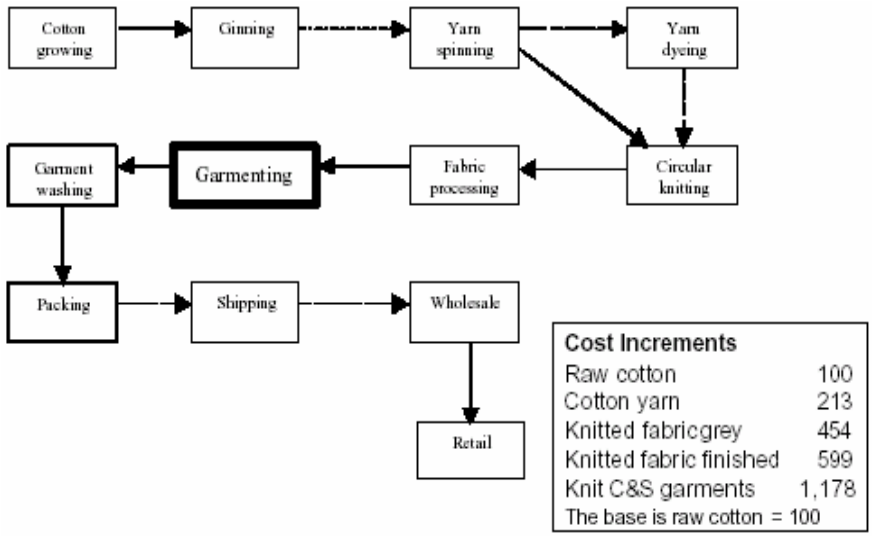
Figure 5: Value Chain: Woven Cut and Sew Garments



3.2 Knit Cut and Sew Garments

The present activities of the Cambodian knit cut and sew garment companies are shown in bold boxes in the following illustration of the textile value chain for knit cut and sew garments in Figure 6. This sub-sector of the industry represents more than 50% of the global garment market today, with particular growth in the sports and leisurewear segments. It is the sub-sector in which most countries have made investments in relatively limited capital cost units (an economic size of knitting with dyeing and finishing capacity of 6 tons per day costs about US$3.5 million). This sector of the global garment industry has become based on such units in order to offer the reduced, competitive lead times demanded by buyers. It is unusual for yarn spinning companies to be backward linked into ginning or into cotton growing. While shipping, wholesale and retail activities are part of the textile value chain, they are not usually the tasks of garment companies.

Figure 6: Value Chain: Knit Cut and Sew Garments



4. Constraints Faced by the Garment Industry

The company-level survey carried out under the ADB TA project confirmed many of the widespread problems facing the industry. Table 2 presents a summary of the six major problems reported by the companies interviewed classified by type of activity. In general, these problems can be classified as (a) operational and (b) structural.

Table 2: Constraints Faced by the Industry

Six Top Issues				
Type of Problem	Knitwear	Woven Cut and Sew	Circular Knit Cut and Sew	Total
Procedures	1.28	1.51	1.42	1.38
Corruption	1.39	1.60	1.08	1.35
Recruiting expatriates	3.06	3.20	2.00	2.78
Worker motivation and Productivity	2.94	2.20	2.08	2.50
Trade unions	2.72	1.90	1.25	2.08
Lead times	1.78	2.10	1.67	1.83
Number of firms	9	5	6	20

Note: 1= very major problem; 2=major problem; 3=average; 4= minor problem; 5= very minor problem

4.1 Operational Problems

Corruption: Interviewed companies in all garment industry sectors reported major problems with corruption and bribery that result in large additional payments, accounting for up to 7% of the total value of sales. Companies operating in Cambodia are conditioned to having to pay unofficial payments, but the amounts demanded by public sector organizations is reported to be on the increase and to bear no relationship to the size of shipments. Two particular examples stand out in the garment sector: first, unofficial payments necessary to obtain required export documentation; and second, unofficial additional costs incurred in transporting a container from the factory by road to Sihanoukville Port, through the port, and during loading on to the ship. During transportation of a container from the factory to the ship (on board), the unofficial costs amount to 37.3% of the total cost including unofficial costs (Table 3). If shipping costs are excluded, the unofficial costs amount to 74% of the official costs.

Complexity of import-export procedures: In addition to unofficial payments relating to import-export procedures, garment companies interviewed confirmed that the bureaucracy associated with importing raw materials and exporting the finished products often results in significant time wasting and unacceptable delays. The amount of time that senior management needs to spend on government-related matters represents a serious misallocation of resources. Table 3 draws together examples from the field interviews carried out under the ADB project. These examples are typical of the official and unofficial costs (charges) paid by garment companies to secure movement of their goods. While actual values clearly vary from company to company, garment companies pay between 200% to 1,400% in extra unofficial charges to obtain export documents and the

time taken for clearance is invariably longer than the official clearance time. These regulatory practices and corruption serve as deterrents to buyers and investors alike. Both groups know that the unofficial payments situation is unpredictable and could worsen.

Table 3: Extra Costs and Delays: Four Examples

Example	**Official costs and times**	**Actual costs and times – official plus unofficial**
1. Export visa - US (Source: ADB Field work interviews)	Cost - US$30 Total US$30 Time: 2 days maximum	Cost - Official US$30 - Unofficial US$70-80 Total US$100-110 Time: Up to 1 - 2 weeks
2. Export documents - EU (Source: ADB Field work interviews)	Cost - US$50 Total US$50 Time: 2 days maximum	Cost - Official US$50 - Unofficial US$100 Total US$150 Time: 7 days on average
3. Export visa - US Rush (Source: ADB Field work interviews)	Cost - US$30 Total US$30 Time: One day	Cost - Official US$30 - Unofficial US$300 Total US$330- 430 Time: One day
4. Transport of one container from factory to ship, including shipping cost (Source: World Bank, 2003)	Cost US$ Transport 323.90 Port charge 130.00 Loading vessel 23.00 Customs 331.62 Shipping 3,106.18 Total 3,914.70	Cost US$ Transport 323.90 Port charge 130.00 Loading vessel 23.00 Customs 331.62 Shipping 3,106.18 Unaccounted 2,327.80 Total 6,242.50 Unofficial: 37.3% of total

Trade unions: Companies reported a number of problems with the trade unions that are active in the garment industry. In many cases, differences in interpretation of the Labor Law resulted in serious conflicts arising within the companies. In large part, the business sector attributes these problems largely to ambiguity in phrasing of the articles in the Labor Law. Issues of particular concern include (a) overtime and night shift payments. (b) provision of health services, and (c) existence of numerous trade unions within the same factory, resulting in unnecessary confusion and conflicting objectives. While industrial disputes are less than previously, any dispute is disruptive to the flow of export orders, costly to both workers and companies, and damages the supply reputation of the companies.

Worker motivation and productivity: Labor productivity is reported to be lower than in competing countries for a number of reasons. These include training methods and low levels of skill development; cultural and communication gaps between workers and supervisors/management; low level of technologies used; low level of worker motivation; the work environment – large sized operations appear to have more problems in motivating workers and achieving productivity levels as high as smaller units with a more 'family' atmosphere; unusually high number of public holidays; and health and stress problems. The goal is not necessarily to work harder, but to work smarter, so that all efforts contribute positively to output and less effort is required in negative work, such as repair work and rechecking.

Recruiting expatriates: While not ranked as seriously as other problems, companies reported two major difficulties with the need to recruit expatriate supervisors and senior staff. First, the cost of employing expatriates is much higher than employing equally

qualified Cambodian workers; and second, expatriate employees face problems in communicating with and understanding the culture of the Cambodian workforce.

Other factor costs: In addition to the problems already mentioned, there are also issues related to other input costs that account for around 18% of total costs (see Table 4). The main issue here, especially for the more machine driven manufacturing processes, is the cost of power. The cost of electricity in Cambodia (US$0.15 per kWhr) is about 2.5 times that of the international average of US$0.06. Investing in a diesel generator reduces the cost to US$0.10 per kWhr, but this is still high compared to the cost of electricity in other countries.

Table 4: Basic Cost Structure for Manufacturing Denim Jeans in Cambodia

	Cost	% of Total
Materials and accessories	US$4.42	65%
Labor	US$1.02	15%
Other inputs	US$1.22	18%
Profits	US$0.14	2%
Total Cost	US$6.80	100%

Source: World Bank, 2003

4.2 Structural Problems

The major structural problem ranked as very high concerning the issue of lead times. This concern was especially serious for knitwear and circular knit cut and sews companies. In a comparative sense, garment lead times from Cambodia remain lengthy, with other major competitor countries able to offer reduced delivery times. The lead-time issue relates largely to the almost complete absence of backward linkages. Cambodia and the garment industry must not ignore the changes to supply chains that are taking place

around the world, partly as a result of the changing trade environment. As other countries have done, investments in Cambodia in up-stream parts of the textile supply chains should be encouraged in order to provide shorter lead times, improve competitiveness, increase the number of direct and indirect jobs in the textile/garment industry, and raise the domestic value added content of exports. Usually, countries exporting woven garments have an upstream primary textile sector and are able to source their raw materials domestically. As a result, these countries, e.g. China and India, are able to reduce their garment lead times in line with buyer requirements and may be able to reduce lead times further. Bangladesh, however, has only a limited number of backward linkages into woven fabric production and processing and consequently has longer lead times than other countries. To improve lead times, the Bangladesh Government is now offering special incentives to encourage links with domestic garment industry investments. Almost all the competing countries have invested in circular knitting/knit fabric processing units during recent years and are able to offer the reduced lead times required by buyers. For example, until 6 years ago Bangladesh imported 80% of the finished knitted fabrics required for making garments. After substantial investment, Bangladesh is now 80% self-sufficient in finished fabric supply and imports only 20% of its knit fabric needs. Cambodia, however, has not made the same investments and is, therefore, disadvantaged. It is likely that this disadvantage will worsen in future when competition between suppliers intensifies and buyers demand shorter lead times.

5. Benchmarking the Competitiveness of the Garment Industry

Given the fact that Cambodia is competing in an increasingly global market, and that the ending of the quota system will make that market even more competitive, this section of

the report presents a benchmarking comparison of Cambodia to the following countries: Bangladesh, China, India, Indonesia, Pakistan, Sri Lanka, Thailand, and Viet Nam. Cambodia's garment industry is the newest of these countries and is now about ten years old. China, India and Viet Nam have long established textile manufacturing traditions going back several centuries, whilst the textile and garment sectors of Bangladesh, Indonesia and Sri Lanka are about 15 to 25 years old. The latter three all started with garment-only industries but recently have invested in backward linkages for selected textile manufactures to feed into their garment companies. Pakistan has grown cotton for centuries but started a textile industry after partition in 1948 and, later, a garment industry following independence. Thailand's textile and garment industry was based partly on indigenous cotton and partly on imported cotton in the beginning, but is now a major player in man-made fiber production.

5.1 Market Performance

For the most part, garment companies within these Asian countries are manufacturing garments to the instructions of Western buyers, so that market performance reflects the garment companies' abilities to respond to buyers' needs. Supply performance and market reliability are reflected in higher prices. For example, Hong Kong typically has price realization levels that are 2 to 2.5 times higher than the price realization of India and Pakistan in the importing markets, even though the methods of 'selling' are the same. Cambodian companies have no active direct selling organizations as their head offices make all business decisions, so the score recorded is 5. Until Cambodian companies develop their own business strategies and sales organizations, and are responsible for their own futures, market performance is unlikely to change, as Bangladeshi, Indonesian,

Sri Lankan and many Indian garment companies are finding. Bangladesh has a weak market image for quality and reliability and also offers no new product development which, in the view of buyers, is considered to be a drawback. Indonesia and Sri Lanka have worked hard to improve their market performances with some success. However, costs in Sri Lanka are rising and companies based there known to be planning to re-locate to other countries.

Table 5: Benchmarking of Market Performance

Factor	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
Delivery reliability	4 to 5	2 to 4	3	3	3 to 4	2 to 5	3 to 4	3
Active marketing	5	4	3	3 to 4	4	3 to 4	4	4
Active selling	5	4	3	3	4 to 5	4	4	-
Perceived market image	4	4	3	3	3 to 4	4	3	-
Own product styling	5	5	2	3	4	4	3	-
Note: 1= excellent; 2= good; 3= average; 4= less than average and 5=weak or poor								

Sources: Gherzi Textile Organization

5.2 Market Access

The respective membership of these countries in preferential market access schemes is shown in Table 6. All the countries are WTO members, except Viet Nam (when that country meets the entry criteria). All the countries are also members of either ASEAN or South Asian Association for Regional Cooperation, and several are seeking membership of other Regional Trade Pacts and Free Trade Agreements in order to gain entry to more advantageous market entry schemes in global markets. ASEAN is holding membership talks with China, Japan and South Korea in order to widen coverage, and India also wants to join ASEAN. Bangladesh and Cambodia are grouped as least developed countries and

have GSP entry to the EU, Australia, Canada, New Zealand, Norway and Switzerland. Pakistan believes that it should be similarly classified.

Table 6: Benchmarking of Market Access

Factor	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
WTO member	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Status	LDC	LDC	DC	DC	DC	LDC	DC	LDC
Access to EU	GSP	GSP	0	0	0	0	0	0
Access to USA	MFN	MFN	MFN	0	0	0	0	0
Use of Cotonou	0	0	0	0	0	0	0	0
Use of AGOA	0	0	0	0	0	0	0	0
Regional Trade Pact	ASEAN	SAARC	ASEAN	SAARC	ASEAN	SAARC	SAARC	ASEAN

Sources: WTO legislation, ASEAN, Cotonou and FTA rules

5.3 Export Trade

China is by far the largest garment exporter, based partly on imported finished fabrics and partly on increasing self-sufficiency, through domestic and foreign textile investments. India is second largest of the countries in garment orders, based mostly on domestic textile production and limited foreign investments. Bangladesh garment exports are the third highest in these countries and have reached a level of about US$5 billion, building on recent domestic investment in textile production and backward linkages. Indonesia is the fourth largest garment exporter, after having been third largest for some years. Indonesia has invested heavily in Man-Made Fiber production, as well as in textile production, so self-sufficiency in materials supply is also increasing.

Table 7: Benchmarking of Export Trade

Factor	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
Exports 1990 US$ mn	0	643	9.669	2.530	1.646	1.014	638	300
Exports 2000 US$ mn	985	4.171	36.071	6.178	4.734	2.144	2.812	900
Exports 2002 US$ mn	1.339	4.131	41.302	5.600	3.945	2.228	2.326	1.000
Share global trade (%)	0	0.59	8.9	2.3	1.5	0.94	0.6	0.3
Share global trade (%)	0.5	2.1	18.3	3.1	2.4	1.1	1.4	0.5
Share global trade (%)	0.7	2.1	20.6	2.8	2	1.1	1.2	0.5

Source: WTO and Cambodian statistics

Sri Lanka is fifth largest exporter of garments, based largely on foreign investments and imported fabrics but with a high degree of self-sufficiency in knitted fabrics sector. Pakistan has focused more on home furnishing textiles that are more suited to local cottons and garment exports (US$2.2 billion) are ahead of Cambodia (US$1.5 billion). Pakistan's garment industry is based almost entirely on domestic investment.

5.4 Marketing and Logistics

Cambodia is disadvantaged relative to the other countries as shown in Table 8. Each of the other countries has domestic access to at least some, if not most, of the materials required in the manufacture of garments. This allows for better performance, in terms of on time delivery and rapid repeat orders.

Table 8: Benchmarking of Marketing and Logistics

Competitive Factors	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
Market orientation-local	5	4	3	3	4	4	4	4
On time delivery	4	3 to 4	3	3 to 4	3	4	3 to 4	-
Fast repeat orders	5	4 to 5	3 to 4	3	4	4 to 5	4	4 to 5

Local yarn supplies	5	3	1 to 2	1	2	1 to 2	3	1
Local fabric supplies	5	3 to 4	2	1 to 2	3 to 4	2 to 3	3	1
Local accessories	5	4 to 5	3 to 4	4	4	3 to 4	4 to 5	3
Note: 1= excellent; 2= good; 3= average; 4= less than average and 5=weak or poor								

Sources: Market research of Ministry of Commerce of Cambodia

5.5 Manufacturing

Cambodia experiences low productivity in the garment industry, as do Bangladesh and Pakistan to a lesser extent. In terms of product quality and social compliance, Cambodia is one of the leading countries, as shown in Table 9. However, recent evidence indicates that other countries have been improving in these areas, so Cambodia's advantage in this respect has been declining.

Table 9: Benchmarking of Manufacturing

Competitive Factors	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
Productivity	4 to 5	4 to 5	2	2 to 4	3 to 4	4 to 5	2 to 3	3
Quality	2	3 to 4	2 to 3	3	3	3 to 4	2	-
Production flexibility	4	2 to 5	2 to 4	2 to 4	2 to 4	3 to 4	2 to 4	-
Small runs	4 to 5	3 to 5	2 to 4	2 to 4	3	3 to 4	2 to 4	3 to 4
Technology-CAD/CAM	3	3	2 to 3	3	3	3 to 4	3	-
Computerized plan/control	3	3 to 4	3	3	3	3 to 4	2 to 3	-
Compliance	2	2 to 3	3	3	2 to 3	2 to 3	2	4
Note: 1= excellent; 2= good; 3= average; 4= less than average and 5=weak or poor								

Sources: Gherzi Textile Organization

5.6 Labor Skills and Training

In each of these countries there is a plentiful supply of female labor available for garment production. The level of education is generally quite low and operator skills are limited. Most companies in all of the countries prefer to train employees in-house by placing new recruits alongside 'experienced' workers rather than by using in-house training facilities for formal training. Management training is a general problem and vocational training schools (VTS), especially in the public sector, are not well supported by the garment industry as the curricula rarely matches the needs of the industry. Suitable training of teachers in the VTS should be a priority, so that they can work within companies and train employees in the necessary skills to achieve the needed standards of quality and work speed. Such employee training will create confidence which, combined with individual bonus payment schemes, will bring about motivation. Productivity levels are in serious need of improvement in several countries, as shown in Table 10.

Table 10: Benchmarking of Labor, Skills and Training Facilities

Competitive Factors	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
Gender	F	F	F	M/F	M/F	F	F	M/F
Availability	1	1	1	1	1	1	2	1
Education level	4 to 5	5	4	4	4	4 to 5	3 to 4	-
Skills	4 to 5	4 to 5	3	3	3	4 to 5	2 to 3	3
Training facilities in-house	2 to 5	5	3	4	4	4 to 5	2	-
Vocational training schools	4	5	3	4	4	4	3	-
Productivity	4 to 5	4 to 5	2	4	3 to 4	4 to 5	2 to 3	-

Absenteeism	2 to 3	3	2	3	3	3	2	-
Work ethics	2	3	2	2	2	3	2	-
Diligence/dexterity	2	3	2	3 to 4	3	4 to 5	2	3
Compliance	2	2 to 3	3	3	2 to 3	2 to 3	2	4
Note: 1= excellent; 2= good; 3= average; 4= less than average and 5=weak or poor								

Sources: ILO country reports, Gherzi Textile Organization,

5.7 Indigenous Raw Materials

Table 11 shows that whilst Bangladesh, Cambodia and Sri Lanka possess no indigenous textile fibers, the other countries have an abundance of cotton, or man-made fibers (MMF), or both. Nevertheless China and Pakistan have to import Man-Made Fiber in order to have the specific material needed for particular garment products and to achieve the necessary price levels. Pakistan imports cotton in order to have the correct lint cotton quality and staple length, whilst Indonesia has only a limited cotton crop and, therefore, needs to import cotton. Bangladesh is totally dependent on cotton imports.

Table 11: Benchmarking of Availability of Indigenous Raw Materials

Fibers	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka	Viet Nam
Cotton	5	5	1	1	4 to 5	1	5	2
Wool	5	5	3	3 to 4	4	4 to 5	5	4
Silk	5	4 to 5	1	3	5	4 to 5	5	4
Polyester-staple	5	5	1	3	1	2	5	5
Polyester-filament	5	5	1	2	1	2	5	5
Polyester-micro	5	5	1	4	1	4	5	5
Acrylic	5	5	1	3	3	5	5	5
Nylon (polyamide)	5	5	3 to 4	3	3	3	5	5
Bast	5	1	5	1	4	5	5	5

Note: 1= excellent; 2= good; 3= average; 4= less than average and 5=weak or poor

Sources: World Cotton Statistics, Man-Made Fiber Production Statistics

5.8 Infrastructure

Cambodia is poorly positioned in terms of infrastructure compared to the other countries. Both Cambodia and Bangladesh face constraints in that they do not have a deep sea port so all imports and exports need to be trans-shipped through a third country, usually Singapore. All other major competitors have their own deep-sea ports. In addition, while Cambodia's infrastructure weaknesses may not be a major concern with regard to railways and telecommunications, this does become a significant and serious issue when production costs and shipment of goods are severely affected by an insufficient and unreliable power supply and expensive electricity costs.

Table 12: Benchmarking of Infrastructure Quality and Availability

Competitive Factors	Cambodia	Bangladesh	China	India	Indonesia	Pakistan	Sri Lanka
Roads	5	5	3	2 to 4	1 to 4	1 to 4	2 to 4
Railways	5	4	3	2 to 3	2 to 4	4	none
Airports	4 to 5	3 to 4	2 to 3	1 to 3	1 to 3	2 to 4	1 to 3
Harbors/Ports	5	5	2 to 3	4	2 to 3	3	2
Container terminals	4	4	2	3 to 4	3	4	2 to 3
Telecom	4	3	3	2	2 to 3	2 to 3	2
Customs clearance systems	4 to 5	5	3	3	2 to 3	4	3
Power-shortage	5	5	3	4	3	3 to 4	3
Power supply breakdowns	5	5	4	4	4	4	2
Power cost	4	3	3	5	2 to 3	3 to 4	3
Note: 1= excellent; 2= good; 3= average; 4= less than average and 5=weak or poor							

Source: Gherzi Textile Organization,

5.9 Factor Costs and Mill Operating Hours

Cambodia's labor costs are competitive in both the textile and garment sectors, as shown in Table 13. However, overtime rates need to be addressed, as they do not correspond with international standards. It is not usual for garment companies to work more than a day-shift but the capital intensive, machine driven primary textile sector has to operate the maximum number of hours a year. It is quite normal for spinning, weaving, knitting and processing plants to work up to 8,640 hours a year, i.e. 360 days of 24 hours, in order to recover depreciation costs more rapidly and to avoid wastage from machine down time.

Table 13: Benchmarking of Factor Costs and Mill Operating Hours

Competitive Factors	**Cambodia**	**Bangladesh**	**China**	**India**	**Indonesia**	**Pakistan**	**Sri Lanka**
wages (US$/Hr including Social charges)							
Textile sector	0.27-0.35	0.30-0.54	0.44-0.76	0.30-0.62	0.30-0.42	0.37-0.42	0.42-0.50
Garment sector	0.27-0.35	0.28-0.36	0.32-0.48	0.30-0.45	0.29-0.36	0.32-0.39	0.32-0.40
Power (US$/kWhr)							
- grid	0.15	0.065	.047-.08	0.1042	.03-.04	.065-.075	-
- own generator				5.83			
Steam-US$ cents/kg steam	-	-	0.58	1.96	0.75	1.41	-
Raw water-US$ cents/m3	-	-	15	13.4	5	14.7	-
Mill hours/year-basic							
Textile mill	none	8.400	up to 8.736	up to 8.736	8.400	8.400	8.400
Garment factory	2.304	2.304	2.400	2.400	2.400	2.400	2.400
Majority of workers							
Textile mill	none	Male	Male	Male	Male	Male	M/F
Garment factory	Female	Female	Female	M/F	Female	Female	Female

Source: Gherzi Textile Organization

Power costs in Cambodia are very high in comparison to all competitors and will need to

be reduced if the primary textile sector is to be competitive. The international standard for electricity costs is about US$0.06 per Kwhr so that Cambodia's present costs of around US$0.15 per Kwhr are about 150% too high.

5.10 Garment Sector Strategies

Each of the selected countries considers their garment industry to be the engine of growth for their national economies, although some countries are more dependent on garment exports than others. For example, Bangladesh, Cambodia, Pakistan and Sri Lanka are dependent on garment exports for more than 70% of their foreign currency earnings. Each of the countries welcomes foreign direct investment (FDI) in the garment and textile sectors in order to bring technical knowledge and market access. Bangladesh and Pakistan have found it difficult to attract FDI because of their unstable law and order situations and, until recently, the random policy changes and the unstable political situation resulting from government changes. Bangladesh recently changed its investment policy in order to attract more FDI. In addition to seeking better market access and technical knowledge through FDI, each of the countries is taking steps to raise productivity levels and to make backward linkage investments into the textile sub-sectors. In particular, all the competing countries, with the exception of Cambodia, have invested increasingly in textile production in order to have greater self-sufficiency in fabric supplies to the garment industry. Sri Lanka, the competing country with the lowest textile production has made significant investments recently in weaving and in circular and flat knitting capacities. In addition, many governments and business communities are undertaking bilateral negotiations to gain preferential access to the main markets – the US, EU, Canada, and Japan. These include efforts to be deemed eligible for duty-free

market access in the US (by a number of Asian exporters, including Cambodia) and also for more favorable (or less restrictive) rules of origin under the EU EBA (Everything But Arms) program.

6. Technological Capability, Productivity, FDI and Industrial Deepening

This section considers some selected key aspects of the Cambodian garment industry in more detail. The areas covered include technological levels and capabilities, productivity, role of foreign investment/domestic investment, and industrial deepening and backward linkage development.

6.1 Technological Levels and Capabilities

In the global marketplace, three levels of garment industry technology can be identified: First, Level 3 Technology: fully automated operations wherever possible, advanced handling methods and equipment. Typical floor area required per operator is 12 square meters. This level of technology is typically found in the highest cost countries such as Germany and Italy, where the labor cost in the garment industry is in the range of US$15 to US$20 per hour, and where the garment industry is consequently becoming minimal except for unique, niche products at high prices. Second, Level 2 Technology: automated features on sewing machines (for quality consistency), engineered work places (for smarter working) and designed handling methods (for efficiency of handling). Typical work area required per operator is 7 square meters. This level of technology is to be found, for example, in Mexico, Thailand and Turkey. Third, Level 1 Technology: manual laying and cutting with basic sewing machines and without work aids (for quality consistency) or labor saving sewing features (for efficiency of handling). Typical floor area required per operator is < 4 square meters. The skills demanded of the workers are

probably higher than for either level 2 or level 3 technologies. This level of technology is to be found, for example, in Cambodia, Bangladesh and Pakistan. In general terms, based on the empirical survey, the levels of technology employed in Cambodia are at the lowest level in sewing and inspection. Few attachments are applied to the machines that could aid workers to operate more effectively, both in volume and quality terms. This is characteristic of countries where labor costs are very competitive as management considers it cheaper to employ people than to invest in machines or specific machine attachments. A few garment firms in Cambodia work with CAD (computer-aided design) systems and laying/cutting machines to minimize waste, but this type of technology is not widespread.

6.2 Productivity

In general terms, the levels of productivity reached in the industry are too low and similar to those in Bangladesh and Pakistan. This is due to a number of reasons including methods of skills development, culture/communication gaps between workers and expatriate production supervisors and other management, low motivation of workers, the large production (Chinese and Vietnamese style) halls in many companies, low levels of technology, lack of engineered work places, and high number of national and personal holidays. Of the three levels of technology used in the garment industry, Level 1 Technology is predominantly used in Cambodia. Since the machines used are basic machines without attachments, the operators need to perform more actions than with automated machines, resulting in a higher work content. Additionally, because the quality of the finished product depends more on the skill of the operator using Level 1 Technology, the probability of substandard work is greater and the need for re-working

garments is higher. This becomes a vicious circle, as more inspectors are required to identify substandard work, etc. The garment industry generally accepts that companies with Level 1 Technology must employ extra people rather than improve technologies used. The Asian Development Bank empirical survey of the Cambodian industry indicates that, even taking this into account, garment companies operating in Cambodia employ around 20-25% more people than is strictly necessary for companies operating Level 1 technology. Accordingly, improvements of 40%-60% are possible in many garment companies, especially the larger ones. It is often possible where labor costs are low to 'solve problems' by putting more and more workers on jobs to clear bottlenecks or other problems as the situations arise rather than to solve the cause of the problem. This only causes the original problem to escalate in terms of even lower productivity levels and higher costs. The situation may be compared with bottlenecks in the primary textile sector where management may choose to install additional machine capacities, often at high cost, that do not result in eradicating the problem but does add to cost and result in an imbalance of machine capacities. In the garment industry, part, or completed, garments are examined. Where faults are found, the seams have to be unpicked, re-worked, re-inspected, and included in the production line again. This takes time, requires additional personnel, and reduces productivity levels. The productivity issue is exacerbated by the number of holidays taken. The highest productivity levels were found in smaller Cambodian companies where management teams train new recruits in accuracy and speed, as well as the quality standards expected of them, and encourage them to be successful. The level of motivation of employees was found to be much higher in these smaller units than in the large companies where employees were just numbers in

departments employing many thousands of workers and were trained by being placed alongside ‘experienced’ workers. Although the garment industry is the engine for growth in Cambodia, investment in systematic skills development of garment industry employees is not commensurate with its significance to the economy. Training of workers is, generally, informal. There is no systematic training for entry into the garment factories. Potential workers either pay a small fee to an outside tailor, usually US$1 per day for 5 to 7 days training to learn to stitch in straight lines, or they receive on the job training after being recruited as trainees. In the case of the latter, a new recruit works alongside an experienced worker and earn wages of about US$1 per day, usually for a period of up to 3 months although this may be extended. The average earnings of an apprentice (trainee) are US$25 -US$30 per month for 48 hours work per week (208 hours per month). In general, the low productivity of workers is considered to be one of the more easily tackled problems. Evidence from the ILO pilot project indicates that labor productivity could be increased by 10% to 29% through improved skills, better human resource practices, and better work ethics and organization.

6.3 Role of Foreign Investment/Local Investment

It is usual for foreign investors to join with local investors in setting up joint-venture companies, where the opportunities are (a) to use locally available material resources, (b) to sell into a strong domestic market or (c) to export the end product into identified target markets. In the case of Cambodia, there are no domestic investors with which to form joint- ventures and only the third option is available. Most Cambodian-based garment companies (woven and knitted cut and sew as well as knitwear companies) are 100% foreign owned. This is an almost a unique situation in global terms. These foreign

investors often have similar units in other garment assembly countries, e.g. Bangladesh, China, Indonesia, Pakistan, Sri Lanka and Viet Nam, and make all strategic business and sales decisions. Fabric/materials are distributed from their central headquarters to the units that produce the garment orders. The decision as to in which of their manufacturing locations make up garment orders is based on the manufacturing skills and costs of each of the units, the lead times available and especially the availability of quotas and preferential market access. After 1 January 2005, the question of quotas no longer apply and production location decisions are increasingly based on product quality, lead times, reliability in meeting delivery dates, productivity and cost competitiveness. Cambodia's cost advantage disappears when quotas end and quota premiums are no longer paid in several competing countries. Delivery lead times is necessarily longer than in countries with domestic textile production; shipments of incoming materials can, and often are, subject to delays in shipment or at the port and so garment exporters may not be so reliable as units in countries that manufacture textiles. Costs are also higher at a time when buyers are looking for faster deliveries for smaller orders at lower prices. The buyers in other countries have indicated that major US and other buyers will focus on buying more from countries with integrated textile value chains. Possibly the value chain can extend back to fiber growing or production, but this is not an essential criteria. Garment companies in such countries are more likely to offer a superior service at lower costs than companies in Cambodia where all materials have to be imported indirectly (via Singapore), processed and exported indirectly (via Singapore). In this context, where will the interests of the dominant foreign investors in the Cambodian garment industry lie? Will this be with their global business or to their manufacturing unit in Cambodia? The

decision is not a difficult one, their global business is likely to be their choice. This is unfortunate because with few domestic investors to support the Cambodian garment industry, and most Cambodian based companies having no significant investment in the country, Cambodia is expected to lose a significant amount of garment business. If the garment companies in Cambodia had been joint-ventures, it could be expected that the local partners at least would an interest in consolidating the position of the garment industry by ensuring the prompt supply of the needed finished fabrics and other input materials. This could be achieved with backward linkages into textile production or strengthening commercial ties for supply capacities. Foreign investors do not see the same need or make the same commitments as would domestic investors.

7. The Backbone of the Industry: Garment Employees

A workforce of over 230,000 persons, earning an estimated US$135 million in wages, forms the backbone of the garment industry in Cambodia. A further number of workers are employed in small- and medium-sized companies that act mostly as sub-contractors. These employees are generally more vulnerable with regard to employment security, payment of minimum wages and decent working conditions. There is also a wide range of informal businesses, largely managed by women that have sprung up around factories to provide support services to garment industry employees, such as food, beauty parlors, child care, etc. The size and extent of these operations is not known precisely. Overall, these employees are generally in a vulnerable position with regard to secure employment, payment of minimum wages and decent working conditions, and some feel that the garment workers do not receive a fair share of the garment industry profits. In 2004, it is estimated that 85% of the garment industry workforce is female, and the industry absorbs

nearly 20% of the female labor force aged 18-25 years. Young women migrate to urban areas in order to provide cash income for their families remaining behind in rural villages. Rural poverty continues to be a major concern, as the small farm holdings in the workers' home villages can no longer sustain the large families. The ongoing migration has resulted in an increase in the incidence of urban poverty. In addition, an estimated 250,000 young people join the labor force in Cambodia every year, so the need to generate new jobs is very high. Outside of the textile/garment industries there are presently few opportunities, particularly for women, except in the tourism sector. When women migrate, their traditional ties with communities are weakened and they forego support such as childcare, neighborhood security, and access to credit from family/community members in times of need. Many of them feel alienated in urban areas and often face social stigma. Garment workers are not considered "good for marriage."

7.1 The Labor Law and the Garment Industry

The timely and transparent implementation of labor laws, that provide adequate protection against exploitation, is a particular concern from the perspective of garment industry employees. The work force, largely female, is disciplined but insecure and often not adequately trained or motivated. Further, the standards of the factory working environment and facilities for sanitation and health vary between factories. The combined effect is a reported high turnover of staff (up to 40% per year in some factories, according to anecdotal evidence). This can be detrimental both to the garment industry as well as to the employees and the families they support. The ratification of the major ILO conventions relating to women and equality by the Royal Cambodian Government in 1997 resulted in an amended Labor Code that requires special and adequate working

conditions and treatment for female workers. This is highly relevant from the perspective of the largely female workforce of the garment industry. There are seven primary areas of the Labor Law of interest from the employee and gender perspectives. These are:

a. Wages, Overtime and Annual Leave (Labor Article 102-119)

Any agreement that would pay a worker at a rate less than the minimum wage shall be void. The minimum wage for the garment industry is US$45 per month for regular (permanent) workers, with entitlement to an attendance bonus of US$5 per month for regular attendance. The overtime rate is 1.5 times the basic rate, whilst the rate for work on Sundays and national holidays is 2 times the basic rate. The normal working week is 6 days, each of 8 hours, with a maximum of 2 hours overtime per day and a total of 30 hours overtime per month. Workers are entitled to a meal allowance of US$0.25 cents in lieu of a meal, when working overtime. All workers are entitled to paid annual leave of 18 days from the first day of employment.

b. Gender discrimination (Constitution Article 36, and Labor Article 12)

Both men and women are constitutionally guaranteed the right to freely choose their type of employment. The Labor Code provides that women should not be discriminated against in hiring.

c. Sexual Harassment (Labor Article 172)

All forms of sexual harassment are forbidden. Women workers

d. Pregnancy and Maternity Leave (Labor Article 182, 1183)

Women workers are entitled to unpaid maternity leave of 90 days. Women with uninterrupted service of a minimum of one year are entitled to maternity leave at half of their regular wage. Employers are prohibited from dismissing women during their

maternity leave.

e. Breast Feeding and Nursing Room/Day Care (Labor Article 184, 186)

Starting from the birth date of the baby, mothers are entitled to one hour per day to breast feed the child during working hours. Companies employing 100 women or more shall set up a nursing room/day care room within their factories. Employer unable to provide this facility, for whatever reason, must pay for women employees' childcare costs.

f. Right to Form Unions (Labor Article 266, 2667, 280, and Constitutional Article 36)

Workers have the absolute right to form unions to promote their interests and to protect their rights. Acts of interference with this right are forbidden.

g. Safe and Sanitary Working Conditions (Labor Article 229, 230)

All factories must maintain working conditions essential for the health and safety of the workers.

7.2 Working Conditions

While there exists much anecdotal evidence on working conditions in the garment sector, the only real information that can be obtained from statistical data, namely the Labor Force Survey of Cambodia, November 2001, concerns average working hours in the garment sector. The overall average is 56 hours per week. NGOs working with garment industry workers report that practice of the above labor laws is not perfect or adequately enforced by government authorities. Several of the Labor Codes do not have penalties attached, making these legal protections virtually ineffective. The ADB TA project company-level survey and Socio-Economic Survey of Garment Employees in Cambodia (SESGEC) both confirm this finding, particularly on issues of overtime, maternity

benefits, meal allowances, annual leave, sanitation facilities, and facilities for breast-feeding and child care. Anecdotal evidence showed that an employee who had been working for four years in a factory was provided a maternity allowance of US$68 by the factory and US$12.5 by the trade union when she had her first child. Her salary at this time was almost US$60 a month.

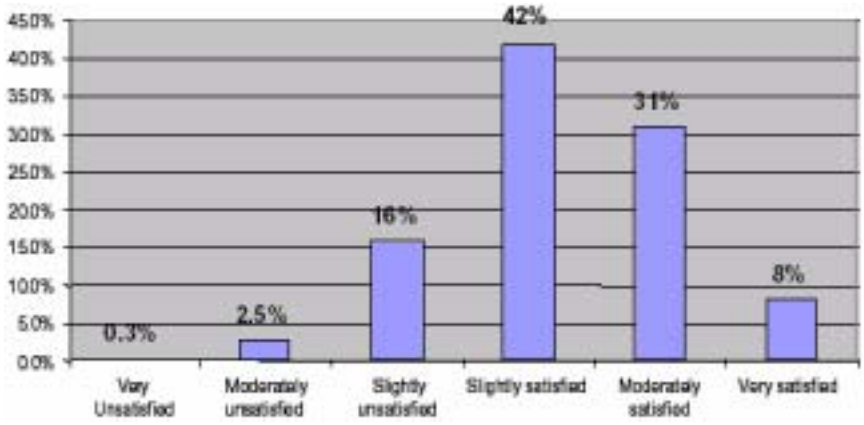
7.3 Garment Worker Characteristics

Overall, it was found that garment industry employees are mainly women (90%) who usually migrate from rural areas and are driven primarily by economic necessity. The Labor Force Survey of 2001 puts this at 85%, while data in the gender assessment of A Fair Share For Women (Cambodian Ministry of Women's and Veteran's Affairs, 2004), confirms the survey findings of 90%. More specifically:

- Typically, women garment industry employees come from large families and their households frequently suffer from droughts and floods, severely impacting their family's rice-farming livelihood.
- Most (over 50%) have a partial elementary education, and 74% were under 25 years old. These women come to work in the garment factories because they see no other economic or livelihood opportunities open to them. Most garment industry employees have no education or do not complete primary school and only a small percentage have access to secondary school and above. Cambodia Development Resource Institute (CDRI) Survey of 2000 confirms that the average educational level of young, female garment industry workers is low. Of those surveyed, 61% had attended only primary school, 31% had attended middle school, and only 8% had a high school education.

- Skill levels are initially low but, either through experience or training, garment industry workers gain the skills required for employment. The largely young, female workforce is viewed as being disciplined.
- Once an employee secures a position, on average they stay in that position in the same factory for several years. Garment industry workers demonstrate little job mobility, although some have moved up to line management positions, and a small percentage has changed factories. Some of the major reasons for leaving a factory are poor health of the worker, in search of higher wages, or a factory slows or closes down production. Overall the majority of garment industry employees surveyed were slightly satisfied or moderately satisfied with their current employment. Often young men and women migrate in groups and have relatives and neighbors from the same village employed in garment factories. The main reason for migrating to the city for work is insufficient food, in spite of the family owning land and other assets. This is because a significant percentage of Cambodia farmers, who previously had a reasonably secure life, are moving towards insecurity due to a number of factors that have made agricultural production uncertain from year to year.

Figure 7: Satisfaction Levels of Garment Workers



Source: ADB, 2004

7.4 Health and Safety Issues

Health and safety factors are of grave concern to garment industry employees. Many feel that they are damaging their health working in a garment factory, and are getting weaker daily. Many workers state that they are breathing in cloth dust without adequate protection and suffer from water-born illnesses, both of which severely affect their health. Medicine costs are a major expenditure for many employees. Other significant expenditures are basic living costs, and sending money home to their parents. Monthly income, including overtime pay, is in the US$50 to US$75 range for most of the respondents. The cost of basic living is usually between US$20 and US$40 while, depending on income for the month, remittances to family are between US$10 and US$30. Employees pay as little as possible on supporting themselves (food, housing, and utilities), so that they can remit more money to their home villages to support their families. This practice also contributes to the generally low level of health. Currently, health care facilities in the garment industry are not only minimal but are generally geared to deal with accidents and fatigue on the job rather than overall well being.

7.5 Income Remittances

Dependence on remittances from garment industry employees has transformed the social fabric of rural communities. The money provided to the families of garment industry employees allows a better standard of living (having enough to eat regularly), allows for repairs to the family home (especially roofs), and most significantly provides educational opportunities for younger siblings. The remittances of the garment industry employees are significant components in the rural livelihood strategies of many families, helping some families to avoid the worst ravages of poverty.

7.6 Human Resource Practices and Management Issues

The total salary received by garment industry employees varies considerably depending on a number of factors, particularly job status – permanent, trainee or temporary - and the amount of overtime worked. According to the results of Cambodia Development Resource Institute (CDRI) survey, about 50% of garment industry workers paid an average of US$38 (about one month's wages), to obtain jobs in the garment industry. This "fee" is paid to a number of people, i.e. factory security guards, interpreters, labor brokers, etc. (MacLean, 1999). Cultural gaps with management were also a cause for concern, and it was noted in many surveys that most garment factories in Cambodia do not have specialist human resource managers. This is a major concern when increasing productivity in garment factories becomes important and calls for the injection of improved human resource management practices into the garment companies. With respect to unions, although workers' unions have extensively developed in the garment sector, these tend to have political affiliations and are often pursuing their own agendas. No attempts have been made to initiate any association or organization using a gender

approach, which is surprising considering that 85-90% of garment industry workers, is female.

Part 3: Conclusions and Recommendations

8. Main Conclusions and Core Vision

The Cambodian garment industry has achieved a great deal during its short history. The garment industry has become the engine driving the national economy, making the greatest national contribution to poverty reduction by having created some 230,000 direct jobs, probably with as many indirect jobs again, and generating the majority of Cambodia's foreign currency earnings. It should be emphasized that the position of Cambodia's garment industry is unique: This is a pre-eminent garment industry accounts for around 12% of GDP, almost 80% of exports, and 65% of manufacturing sector employment, yet the garment sector is built essentially on the basis of the quota system and relatively small comparative advantages in terms of labor cost. The garment industry is essentially dominated by offshore owners that also have garment units in other countries and who carry out all marketing and financing decisions. Few domestic investors have taken a significant interest in the industry, for historical and political reasons. Few backward linkages exist and, therefore, lead times are almost exclusively based on imported materials, resulting in extended and unreliable delivery times. Labor productivity in the garment industry is amongst the lowest of the competing countries. Global markets change extensively and rapidly in the near future as textiles and clothing quotas were ended. Cambodia has no major unique market cost position, and although labor compliance is a positive feature, the industry is likely to need to continue to depend on preferential market access for the foreseeable future. The Cambodian garment industry

needs to become more competitive in terms of cost reduction and delivery times or sections of the industry can fail. How the domestic garment industry responds to the market changes depend on the strategies of offshore investors and of the Royal Cambodian Government. The majority of factory managers in Cambodia appear to be adopting a "wait and see" position, while the decisions of offshore investors are likely to respond more quickly to global developments in the garment industry. With regard to government policies, with bureaucrats well known for delaying shipments or orders, significant reforms are called for in order to prevent garment business moving away from Cambodia as the garment industry's competitiveness steadily declines. If improvements are not made, then the numbers of direct and indirect workers in the garment industry can fall sharply, and the economy of Cambodia can be seriously damaged. It is anticipated that the Royal Cambodian Government will want to ensure that this situation does not arise and that positive progress will be made. Box below draws together the analysis in strengths, weaknesses, opportunities and threats (SWOT) framework. The basic elements identified in the SWOT table are outlined in this study. However, drawing together the key constraints supports the view that, in order to maintain and develop the existing market share, the Cambodian garment industry must identify and exploit opportunities in niche markets that suit the existing industrial base and capabilities.

SWOT Analysis of the Cambodian Garment Industry

Strengths	**Weaknesses**
• Some acquired know-how and experience in the industry, including within the semi-skilled labor force • Strong offshore investors with technical and commercial know-how	• Industry heavily focused on cut, make and trim (CMT) garment manufacture, with all major decisions across the board taken off-shore

and capital resources • Current preferential regimes in terms of duty-free access – to the US, EU, Canada, Australia, New Zealand and Norway • Large pool of unskilled cost-effective labor available from the rural areas to support expansion of the industry if required • Large levels of exports and experience in the export markets • Positive market image, especially in the area of labor utilization and compliance	• Lack of inter-industry linkages and few serious subcontractors, and policy impediments to backward linkage development • No Cambodian lead investors in the industry • Low level of human resource development and low skill base resulting in low productivity and higher than necessary costs • Shortage of skilled middle-management/shop floor supervision /skilled workers • Heavy use of expatriate supervisors leading to culture and communication gaps • Seriously low levels of local value added, and low levels of technology as well • Longer lead times than competitors • High levels of official and unofficial transactions costs, especially in the import/export processes • High costs of power and other utilities
Opportunities • Potential to enhance the productivity of the labor force through training and better human resource practices • Potential in the EU market as former Eastern European members of the EU become less competitive • Potential in the US market, especially if preferential access to this market can be enhanced • The establishment of an Export Processing Zone • Investment in backward linkages • Regional integration with ASEAN countries and ASEAN cumulation • Benefits of WTO membership	**Threats** • Performance of competitor countries, such as China, Bangladesh, Vietnam, etc. • Unwillingness of local investors to enter the garment sector • Phasing out of preferential market access agreements • Possible instability resulting from labor disputes and the high costs resulting from certain provisions in the labor law

9. Key Recommendations

Cambodian Garment Industry Development Strategy A new strategy is required for the Cambodian garment industry as the quota system ends. The garment industry is on the verge of either further development or severe decline. The Cambodian Garment Industry Development Strategy (Development Strategy) should focus on addressing the competitiveness of the industry and on developing policies and actions to address key weaknesses and to harness key opportunities. The Development Strategy must recognize the cross-sectoral nature of the proposed policy measures and actions and should focus on all aspects of the garment industry cluster. A set of actions in a Strategic Plan must be developed, with clearly defined and delegated tasks to ensure that outlined actions and policies are properly implemented. Broader macroeconomic and infrastructure investment impediments need to be addressed simultaneously with proposed garment industry reforms to guarantee success. If only the garment industry takes corrective action in accordance with the new strategy but policy framework remains unchanged, the impact will be limited.

9.1 Strengthen the Necessary Institutions and Build an Information Base

An important element of the Development Strategy will involve bringing key stakeholders into the development and implementation of actions and policies to enhance the competitiveness of the garment sector. In this process, a number of important aspects will need to be considered (in the short to medium term):

First, the development of high-level and cross-sector comprehensive policy reform and a donor coordination mechanism to (a) oversee implementation of the elements of the Action Plan, (b) coordinate and plan allocation of donor interest and resources to the

garment industry, and (c) develop an action oriented public-private sector dialogue.

Second, strengthen Garment Manufacturers' Association of Cambodia (GMAC), the dedicated trade association of the Cambodian garment industry. In the post-quota period GMAC's role should be less that of lobbying government and more of providing the garment industry with market research data and skill development services, of interfacing with government and trade unions on behalf of members, and of undertaking trade promotion and participation in international fairs.

Third, strengthen skill development institutions for entry-level training, for enhancing skills for increased productivity and, to a lesser extent, for preparing garment industry employees for employment in other growth sectors.

Fourth, strengthen employee organizations, as these also become more active in undertaking initiatives to strengthen productivity.

Fifth, development of an information and analytical base on the Cambodian garment industry, both (a) on the activities within the industry, including information on suppliers of products and services used in the garment industry; and (b) on the activities of the various donors. GMAC (Garment Manufacturers' Association of Cambodia) could play a critical role in developing these information bases, drawing together the information available within GMAC, from the Cambodian Ministry of Commerce, from the Cambodian Investment Board, from the Cambodian Department of Customs, and from other sources both domestic and international.

Sixth, development of an information base on international market data, possibly within GMAC, on global trends in the garment industry, on developments in preferential market access schemes and the multi-lateral trading system, on sourcing possibilities in

neighboring countries, and on benchmarking Cambodia against major competitors. This information base would be designed to serve both members of GMAC and the public sector, and with information on the domestic garment industry this could be disseminated to some degree through the Internet.

9.2 Maintain and Improve Market Access

There is considerable evidence that close partnerships between the public and private sectors, in the form of immediate negotiations and lobbying, could play an important role in capturing for the Cambodian garment industry more favorable market access to the major markets. Ultimately, market access is one important key to the garment industry's successful performance.

The activities required in the short-medium term include: Building on and supporting the garment industry-financed lobbying efforts in the US market to obtain GSP duty-free market access similar to that obtained by AGOA (African Growth Opportunities Act) countries.

Campaigning for reform of the EU market access scheme, including: (a) relaxing the rules of origin of the ASEAN cumulation requirements and, in particular, including China as a qualifying input supplier; and (b) reducing the domestic content requirements for GSP duty-free access from existing levels of 50-60% to a lower level that would benefit higher value-added products from Cambodia.

9.3 Reduce Transaction Costs

The changes recommended are significant with regard to the costs of doing business, bureaucratic delays and unofficial costs that damage the image that Cambodia presents to buyers and investors.

The recommended changes include:

- In the short-term, explore as a matter of urgency the possibility of using bonded warehouses as a means of reducing the steps required to process imports and exports, including the possibility of customs clearance at garment factories instead of at the port. Reduce the level of unofficial payments and urgently evaluate alternative mechanisms to streamline, make transparent, and computerize import/export documentation procedures to expedite shipments

9.4 Shorten Lead Times and Improve Business Operations

A critical element of the Development Strategy must involve improvements in the manner in which business operates and also creating an environment that is conducive to the reduction of lead times, which are already important in the future. This element of the overall Development Strategy is complex and complicated and addresses a number of critical constraints. First, the need to deepen the supply chain to build greater value-added and reduce lead times, and second, the need to attract Cambodian investors into the garment industry and in the supply of inputs and ancillaries; and third, the need to leverage existing resources in the garment industry. The components of this element of the Development Strategy should include:

- In the short-term, implementation of an investment promotion drive to create awareness of the Development Strategy and the commitment of the Royal Cambodian Government. The following activities are recommended:

1. Implementation of an investment promotion activity to domestic investors (both male and female entrepreneurs) and potential foreign joint venture partners. This should involve the preparation of investment opportunity profiles for selected

economic-size model factories to support efforts to attract Cambodian investors to various parts of the garment value chain, to stimulate the growth of backward linkages, and to improve lead times in the industry;

2. Visits to Cambodia-based companies that have been receiving approvals for large investments, apparently for backward linkages, to understand what these projects how they relate to the development of backward linkages in the garment industry;
3. Visits to, the mainly East Asian, offshore owners of major garment manufacturers in Cambodia;
4. Targeted investment promotion visits to other potential investors in neighboring countries and selected locations in Europe and elsewhere. These visits could include companies seeking to relocate dyeing and finishing plants from higher cost countries, e.g. from the EU, Singapore and Malaysia, and preferably with the foreign company investing in Cambodia with used plant and domestic partners on a joint-venture basis.

- In the medium-term, the promotion of investment in backward linkage development (especially in the knitwear segment) with the explicit involvement of both foreign and domestic investors. In addition to promotional activities, carefully explore the feasibility of a “Garment Industry Investment Fund” to address market failures in the Cambodian investment environment (in terms of raising finance domestically) and support investments in backward linkages in the garment industry (especially to encourage domestic investors to enter the industry).
- In the medium-term, integrate Small-Medium Enterprises (SMEs) more closely

into the garment industry cluster. There are many small and medium-sized companies in garment (and non-garment) manufacturing that are of less than economic size, either in technical terms or from commercially. These companies could, if 'clustered together' in some form, increasingly contribute to export sales, as in other countries. The precise form of clusters depend on the specific needs of the companies concerned. Cluster options should be varied and could include (i) bringing companies together under one roof, (ii) to organizing a common marketing activity, and options to be determined following discussions with interested companies. Two key policy reforms would be required to achieve this:

1. First, the present investment promotion code involves very high minimum levels of investment that strongly discourage SMEs from entering the garment sector. The Cambodian Investment Board, in its development of the new investment conditions, should carefully consider revising these high minimum investment levels significantly downwards, for example from US$1 million to US$25,000.
2. Second, the VAT (Value Added Tax) imposed on sub-contracting arrangements should be refunded more promptly and completely, or perhaps sub-contracting activities could be exempt from tax.
3. In addition, a recent ADB Technical Assistant study for the Cambodian Ministry of Industry, Mines and Energy (2004) on SMEs proposed an innovative set of measures to remove additional impediments to SME development. The garment industry should support such measures where relevant.

- In the medium-term, strengthen supply chains through better regional integration into ASEAN, in particular Thailand, Viet Nam, and Indonesia. It is necessary to

carefully identify Cambodia's agenda in each market and then to make sure that it is realized. In Thailand, for example, this could involve a combination of supply arrangements to speed up delivery of certain inputs into the production process and the relocation of Thai garment producers to industrial zones just over the border in Cambodia. In Viet Nam, this could be to take advantage of the need for Vietnamese garment producers to use offshore locations to be able to access markets and their willingness to provide cheap inputs such as electricity. The potential impact of the proposed ASEAN-China Free Trade Agreement must also be taken into account.

- In the long-term, through expediting and promoting export processing zones (EPZs) projects that have under consideration for some time already. EPZs offer the potential to bring together in one geographical area all elements of the garment cluster – the garment companies themselves, SME suppliers, service providers, training institutes, involved government agencies, etc.

9.5 Improve the Marketing Environment

Among garment buyers globally, the label "Made In Cambodia" has become synonymous with labor compliance and quality. However, beyond this relatively small group of buyers, the prevailing image of Cambodia in the global market-place is generally not a positive one, and does not reflect the reality of Cambodia as a suitable location for garment production with high levels of compliance with international labor conventions. In addition, as is evident from analysis of export markets, Cambodia remains highly dependent on the US and EU markets.

Two sets of related activities have been called for by GMAC (Garment Manufacturers'

Association of Cambodia) and should be considered, both would be more practical if the presence of domestic investors in the market was greater. These activities are:

- First, in the short-medium term, the Royal Cambodian Government and the private sector should consider establishing a marketing plan to promote the "Made In Cambodia" garment label as a brand that represents compliance, quality, reliability and service. This could be supplemented by the development of a sophisticated labeling campaign (involving the design and production of high quality Cambodian labels for certain select products) that will create and enhance a distinctive image for Cambodian garment products. This must, of course, be designed to complement the existing marketing strategies of the major offshore producers and buyers, and should not compromise sourcing strategies.
- Second, in the medium term, the proposed image building campaign could be complemented by an ongoing and sustained export promotion campaign. This would be based on careful research of the potential markets and product opportunities, carried out in close collaboration between the garment industry and the RCG, and aimed at diversifying export markets for garment products made in Cambodia.

9.6 Address Other Major Cost Items

While there are a number of other cost items that are of concern to industry in general, two of these have been identified as important for the garment and textile industries and need to be addressed. These are:

- First, the extremely high cost of electricity, something that may not be that important to the garment industry but which is important to backward linkage

activities that are more capital and energy intensive. In many of these activities power costs are the second highest cost after raw materials, and often more than 15 times that of labor.

- Second, the unofficial costs in transportation of a container from a factory to and through the port of Sihanoukville and onto a ship.

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